CITIZENS COMMUNICATIONS COMPANY
ARIZONA GAS DIVISION
DOCKET NO. G-01032A-02-0598

TESTIMONY OF KEVIN DOHERTY

REVISED

INTRODUCTION

Q. Please state your name and business address.

A. My name is Kevin H. Doherty. My business address is Citizens Communications Company, 3 High Ridge Park, Stamford, Connecticut 06905.

Q. By whom are you employed and in what capacity?

A. I am employed by Citizens Communications Company ("Citizens") as a Regulatory Accounting Manager.

Q. Please describe your current duties and responsibilities.

A. I am responsible for the preparation of regulatory studies for Citizens' Public Service Sector, which includes both the Northern Arizona Gas Division ("NAGD") and the Santa Cruz Gas Division ("SCGD"), collectively referred to as the Arizona Gas Division ("AGD" or "Company"). In addition, periodically I appear in regulatory proceedings on behalf of Citizens, and present testimony and exhibits supporting applications that have been filed.

Q. Please summarize your educational background.

A. I graduated from Pace University in 1987 with a Bachelor of Business Administration degree in Accounting, and I am currently enrolled in Pace University's MBA program. I have attended numerous seminars and presentations that addressed accounting, rates and other financial matters.

Q. Please describe your work experience.

A. From 1987 to 1989, I was employed by Arthur Young and Company as a Staff Auditor. I participated in audits for clients in the manufacturing, energy, and defense industries. I have been employed by Citizens since 1989. From 1989 until 1994, I held the position of Senior Capital Asset Accountant, responsible for preparation of various plant in service and depreciation reports, and I provided data for rate proceedings and certain bond indenture requirements. In 1994, I was promoted to Senior Regulatory Accountant and participated in rate proceedings in the states of Ohio and Illinois. In 1995, I was promoted to Regulatory Specialist, and testified on rate base in rate proceedings in the states of Pennsylvania and Arizona. In 1998, I joined a Citizens-wide team responsible for the implementation of an integrated accounting software system. In 1999, I accepted a position as Manager of Regulatory Accounting. In 2002, I testified in a rate proceeding in the state of Vermont.

Q. What areas will you address in this testimony?

A. I am presenting certain items included in Schedule B of Arizona's standard filing requirements relating to rate base, certain operating expense items included in Schedule C of the standard filing requirements, and all of the financial statements and statistical schedules contained in Schedule E of the standard filing requirements. These schedules were filed as part of this rate application and are found in their own bound volume. With respect to rate base, I will address the following:

- Summary of Rate Base Elements
- Gross Utility Plant in Service
  - Original Cost

  - Reproduction Cost New ("RCN")
- Accumulated Depreciation
- Contributions in Aid of Construction ("CIAC")
- Amortization of CIAC
- Customer Deposits, Materials & Supplies, and Warm Spirit
- Advances in Aid of Construction ("AIAC")
- Gain on Sale of Property
- Y2K Deferred Costs

The summary of all rate base components, including those that I am supporting, is set forth in Schedule B-1, which is described below.

With respect to operating expenses, I am sponsoring Schedule C-1, which shows the recorded, adjusted, and pro forma income statement at present and proposed rates, and Schedule C-2, which summarizes the income statement pro forma adjustments made to the test year. I will also address the following specific adjustments to Schedule C-2:

- Revenue adjustments (Schedule C-2, Adjustment A),
  - Elimination of Unbilled Revenue (Adjustment A-6),
  - Adjustment to Detailed Bill Calculation (Adjustment A-7),
  - Adjustment to Detailed Public Authority Calculation (Adjustment A-8),
  - Elimination of Prior Year PGA Adjustment (Adjustment A-9),
  - Correction for April Revenue, Not Recorded (Adjustment A-10),
  - Miscellaneous Adjustments to Reconcile (Adjustment A-11),

- Uncollectible Expense and Interest on Deposits (Adjustment C),
- Depreciation Expense (Adjustment I),
- Lease Expense for New Office Facilities (Adjustment J),
- Amortization of Gain on Sale of Property (Schedule B-12, Adjustment M),
- Maintenance Expense Related to Gas Supply Line (Adjustment N),
- Y2K Expense (Adjustment O), and
- Postage Expense (Adjustment P).

I will also present Schedule C-3, which computes the Gross Revenue Conversion Factor. As discussed in the testimony of Messrs. Cohen and Smith, Citizens is seeking to consolidate its NAGD and SCGD properties for ratemaking purposes. Therefore, the rate base, revenue, and operating expense adjustments that I am sponsoring were calculated based on the separate recorded amounts for the two properties, and then were combined into the consolidated AGD amounts that are shown on the schedules in this filing.

RATE BASE

Q. Please describe Schedule B-1, containing the Summary of Rate Base Elements.

A. Schedule B-1 summarizes the components of rate base on both a net recorded original cost and a depreciated reproduction new cost basis. The supporting details and calculations of the various components of rate base are contained in subsequent schedules in Section B.

Q. Please discuss Gross Utility Plant in Service.

A. Schedule B-2 is a one-page exhibit that displays the pro forma original cost net plant in service for the test year that ended December 31, 2001. It includes the adjusted plant in service and accumulated depreciation for the AGD that are developed in Schedules B-~~5~~4A and B-~~5~~4B, respectively.

Q. Is the Company including any amounts for acquisition adjustments in its revenue requirement in this proceeding?

A. No, it is not.

Q. Where are the amounts associated with the acquisition adjustments reflected on the Company's accounting records?

A. The amounts are shown in Account 114, Plant Acquisition Adjustments, which are not part of the Utility Plant in Service that is included in Account 107.

Q. Did the Company make any adjustments to any rate base or expense elements included in the rate application that are related to the acquisition adjustments?

A. Yes, the Company has removed the Accumulated Deferred Income Taxes ("ADIT") associated with the acquisition adjustment from the recorded ADIT in its application. These adjustments are included on Schedule B-7 and supported by the testimony of Mr. Apuzzo.

Q. Is the Company requesting that any Common Plant be allocated to or from the AGD in this proceeding?

A. No, it is not. Citizens has administrative operations in Stamford, New Orleans and Rochester, where work is conducted for the benefit of the AGD. However, the Company has not included any utility plant in service from these administrative operations in its calculation of rate base in this proceeding, as shown on Schedule B-2, Line 2, and on Schedule B-~~3~~6. In prior rate cases in Arizona, some of the items included as part of Common Plant have been contested. In addition, the plant value has been sufficiently depreciated so that the net plant amount is not significant when allocated to the AGD in this proceeding. For these reasons, the Company has elected to remove these elements from rate base for this filing. Removing these elements reduces the overall revenue requirement in this proceeding.

Q. Has the Company also excluded Common Plant allocations among its Arizona Operations, such as the gas and electric divisions?

A. Yes, it has. These amounts are small and would tend to offset each other. Again, rather than burden this proceeding with those items, the Company has decided to forego those allocations in this rate proceeding. In general this means that there is no allocation of AGD plant to Citizens' electric operations and no allocation of Citizens' electric plant to its AGD operations.

Q. Please describe Schedule B-43.

A. Schedule B-43 is a one-page exhibit showing the Trended RCN plant and accumulated depreciation for the AGD. The Arizona Constitution requires that the Arizona Corporation Commission ("Commission") set utility rates on the basis of a "fair value". Historically, this was established using a rate base that was equally weighted with net original cost and depreciated reproduction cost new ("RCN"). This schedule complies with that requirement by showing plant and accumulated depreciation calculated by trending original cost to produce a RCN. (In Mr. Mason's testimony, he explains the methodology for deriving the trended RCN plant amounts.) The RCN Plant in Service is brought forward from Schedule B-~~5~~4, described below. On that schedule, I derive the ratio of depreciable RCN plant to depreciable original cost plant. Multiplying that ratio by the amount of original cost accumulated depreciation (from Schedule B-~~5~~4B) produces the amount of RCN accumulated depreciation.

Q. What does Schedule B-~~5~~4 show?

A. Schedule B-~~5~~4 is a one-page summary exhibit identifying pro forma original cost and RCN as of December 31, 2001, by major plant account. This schedule serves two purposes. First, it shows the detail plant account data that are summarized on Schedule B-1. Second, it shows the detail of the total RCN (on Schedule B-~~4~~3), consistent with the Arizona constitutional requirement to present a fair value rate base. The original cost plant amounts on Schedule B-~~5~~4 are developed on Schedule B-~~5~~4A. The RCN amounts on Schedule B-~~5~~4 are developed on Schedule B-~~5~~4C.

Q. Please describe Schedule B-~~5~~4A.

A. Schedule B-~~5~~4A starts with the recorded original cost plant amounts, categorized by major plant accounts, and shows the pro forma adjustments to plant in service. Finally, this schedule presents the pro forma plant balance as of the end of the test year.

Q. Please discuss the first pro forma adjustment, relating to the Griffith Transportation Agreement.

A. As Mr. Smith describes in his testimony, Griffith is an electric generating facility with which the NAGD has a contract to provide facilities and certain services for 20 years. The Commission approved the contract between NAGD and Griffith conditioned on the requirement that the NAGD remove all associated revenues, expenses, plant investments and related amounts in any subsequent regulatory proceeding. The NAGD has recorded all Griffith plant under a separate code in the plant accounts to ensure that such plant can be removed in the regulatory process. Similarly, the NAGD has maintained accumulated depreciation under a separate code to permit removal. Adjustment A, Column 3 on Schedule B-~~5~~4A, reflects adjustments to plant to remove all Griffith-related plant investments. (Schedule B-~~5~~4B, discussed below, reflects the associated adjustments to accumulated depreciation associated with this and other pro forma plant adjustments.)

Q. Please discuss Adjustment B, Column 4, relating to the SCGD Supply Line.

A. Citizens' Santa Cruz Electric Division ("SCED") owned a gas supply pipeline that was used to provide natural gas to fire its electric generators. SCED has recently transferred this asset to the SCGD to ensure that all gas plant assets are held by the AGD. The assets related to the supply pipeline have been identified, and are included as SCGD plant as shown in Column 4 of Schedule B-~~5~~4A. The related accumulated depreciation is shown on Schedule B-~~5~~4B.

Q. Please discuss Adjustment D, in Column 6, Schedule B~~5~~-4A, relating to the NAGD Paulden Line.

A. NAGD constructed six miles of 8-inch pipeline for the specific purpose of supplying natural gas to NutriSource, LLC, a company that was developing the Paulden Greenhouse Facility for the production of greenhouse tomatoes. Unfortunately, the company's venture was unsuccessful, and NutriSource is no longer in business in Paulden, Arizona. While this pipeline does serve a handful of customers, the AGD has removed this pipeline from plant in service for purposes of this proceeding. Column 6 of Schedule B-~~5~~4A reflects the removal of the Paulden Line from the plant accounts.

Q. Please discuss Adjustment E in Column 7, relating to Plant Retirements.

A. Following the test year, Citizens conducted a physical inventory of its Arizona General Plant accounts and also made a review of the plant accounting property records to determine if there were any assets on the AGD books that should be retired. As a result of these activities, ~~the~~ Citizens determined that approximately 1.1% of total plant, $2.6 million, should be retired. The AGD will formally retire the assets so identified during the current fiscal year. I have reflected these retirements as a reduction to plant in service in Column 7 of Schedule B-~~5~~4A (and the corresponding symmetric reduction to accumulated depreciation).

Q. Please describe Adjustment F in Column 8, relating to the Yale Street Building.

A. As discussed in Mr. Smith's testimony, as a cost-cutting measure, the AGD recently moved out of its administrative office building located on Yale Street and has moved into a leased facility. Both buildings are located in

Flagstaff, Arizona. The Yale Street building and associated assets have been identified, and I have removed those assets and the related Accumulated Depreciation from Plant in Service in Column 8 of Schedule B-~~5~~4A and on Schedule B-~~5~~4B respectively. In addition, Mr. Apuzzo has made an adjustment for the ADIT related to that plant and I have included the lease amount for the new facility as an expense in this proceeding.

Q. Please discuss Adjustment G in Column 9, relating to Allowance for Funds Used During Construction ("AFUDC").

A. As discussed in Mr. Mason's testimony, the Company (as well as other Citizens properties in Arizona) is required to adjust its AFUDC rate consistent with the settlement agreement that the Commission approved in Decision No. 61848, issued July 1999. To conform to the proper procedures outlined in the AFUDC Order, the AGD has revised its test year plant accounts. These revisions are shown in Column 9 of Schedule B-~~5~~4A.

Q. Please describe the adjustments in Column 11 for Account Corrections.

A. These adjustments reflect the transfers of plant amounts among accounts that result in a zero balance on the total plant line, Line 39. Dr. White, the Company's depreciation expert, has recommended these adjustments as a result of his work in connection with his Depreciation Study.

Q. What is shown on Schedule B-~~5~~4B?

A. Schedule B-~~5~~4B starts with the recorded original cost accumulated depreciation, categorized by major plant accounts, and shows the pro forma adjustments corresponding to each of the pro forma plant adjustments contained in Schedule B-~~5~~4A. Finally, this schedule presents the pro forma accumulated depreciation as of the end of the test year. The adjustment columns (Columns 3-11) mirror the columns as described in connection with Schedule B-~~5~~4A, above, with the exception of Column 11 for the Account Corrections. This column also includes ~~two~~an adjustments that removes a minor debit balance~~s~~ in Account 365.10.~~in the amount of $5 and in Account 389 in the amount of $5,618.~~ Th~~ese~~is amounts w~~ere~~as incorrectly recorded in th~~ose~~at account~~s~~ in prior years.

Q. Please describe Schedule B-~~5~~4C.

A. Page 1 of Schedule B-~~5~~4C shows the RCN plant amounts, by major plant account and by business area. In addition, the adjustments to plant shown on Schedule B-~~5~~4A are trended and shown in Column 9. Page 2 of the schedule reflects a summary of the original cost plant in service by each business area that was used to determine the RCN amounts described earlier in my testimony. This is provided to verify that the Company has included all plant in its calculation of the RCN used to determine the Fair Value Rate Base. These amounts exclude the Griffith Plant adjustment.

Q. Please describe Schedule B-8.

A. Schedule B-8 is a one-page exhibit summarizing the rate base deduction for CIAC and related accumulated amortization. This exhibit shows the amount of CIAC, $8,467,783, and Accumulated Amortization, $1,733,000, at the end of the test year.

Q. Does the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts require that CIAC amounts be offset against plant?

A. Yes, it does.

Q. Does AGD comply with that FERC requirement?

A. Yes. The CIAC amounts are recorded as credits in the plant accounting system and are offset against the related plant amounts. This permits the Company to comply with the FERC requirement and also maintain the gross plant amounts with the related CIAC for presentation in rate applications. The CIAC amounts are shown on a gross basis for rate case presentation purposes and are amortized using the depreciation rates for the related accounts. The annual amortization amounts are offset against the depreciation expense amounts for the plant in compliance with the Commission practice in prior Citizens' rate cases.

Q. What is the CIAC accumulated amortization balance?

A. The CIAC accumulated amortization balance at the end of the test year is $1,733,000, as shown on Column 5 of Schedule B-8. The annual amortization amount is calculated using the approved depreciation rate times the account balance, resulting in $214,928 for the test year, as shown in Column 4 of the schedule.

Q. What is included in Schedule B-9?

A. Schedule B-9 summarizes the monthly balances of several rate base components during the test year. These components are customer deposits, materials and supplies, and the Warm Spirit Program (a low-income program described in Mr. Smith's testimony). Consistent with prior rate cases, the amounts are reflected in rate base using an average of the thirteen monthly balances ending December 31, 2001. A companion adjustment for the annualized interest on customer deposits is included in pro forma test year operating expenses as Adjustment C of Schedule C-2.

Q. Please describe Schedule B-10.

A. Schedule B-10 summarizes the rate base deduction for customer AIAC. AIAC represents amounts of non-investor supplied capital received by the Company and used to fund construction of utility plant.

Q. Please describe Schedule B-12.

A. Schedule B-12 contains a rate base deduction for deferred portions of gains realized from the sales of utility assets. In accordance with Commission policy, when utility assets are sold and removed from the provision of utility service, fifty percent of the after-tax gains are to be shared with ratepayers.

In late 1998, Citizens sold an office building located on San Francisco Street in Flagstaff to a non-utility purchaser. The building would no longer be useful or necessary in providing utility service. The transaction produced an after-tax gain totaling $140,650. Fifty percent of that amount was credited to a regulatory liability pending its disposition in the next rate case.

In November 2001, Citizens sold an office building in Cottonwood. That building was also removed from utility service. That sale produced an after-tax gain of $68,212. Fifty percent of that amount was credited to a regulatory liability pending disposition in the next rate case.

Q. What treatment does the Company propose for these gains on sale?

A. The AGD proposes to amortize the combined $104,431 deferred customer share of the gains from the property sales over a period of five years and reduce rate base by the unamortized amount. Accordingly, in this application, rate base is reduced by $104,431, with a corresponding negative amortization of $20,886 reflected in operating expense as Adjustment M on Schedule C-2.

Q. Please discuss the adjustment for Y2K costs.

A. This adjustment relates to the Company's allocated portion of Citizens' expenses incurred with becoming Y2K compliant. It is the corresponding rate base amount associated with the amortization described as Adjustment O to Schedule C-2, below. The Y2K costs and recovery that is being sought are discussed in more detail later in my testimony.

OPERATING INCOME

Q. What is shown on Schedule C-1?

A. Schedule C-1 contains the income statement for the test year ended December 31, 2001. Recorded amounts, pro forma adjustments for known and measurable changes, and the resulting pro forma test year amounts are shown for revenues, by class of service, and for operating revenue deductions by major function. The schedule also includes the effect of the requested revenue increase and the adjusted test year income statement at proposed rates.

Q. Please explain briefly the computation of pro forma test year revenues and expenses.

A. The ratemaking process involves the determination of a utility's revenue requirement based on a test year that reflects a level of operating revenues and expenses and net plant investment that is representative of normal conditions, free of any distortions. The rates to be derived are not necessarily intended to recover specific test year costs, but rather, similar costs expected to be incurred in the future.

Pro forma adjustments are made to address any revenues or expenses that are not representative of the levels expected to occur during the period in which the new rates will be in effect. Such adjustments may be in the form of eliminations, annualizations, or normalizations.

Q. What are elimination, annualization, and normalization adjustments?

A. Elimination adjustments are made to remove out-of-period items or items that are not costs or revenues related to the provision of utility service; thus, not includible in revenue requirements.

Annualization adjustments are made to reflect the full, twelve-month revenue or expense level of certain items of operating income. Examples include restating test year revenues to reflect customer levels at the end of the test year, adjusting payroll expense for the effect of salary adjustments or changes in employee levels since the beginning of the test year, and adjusting recorded depreciation expense to reflect the full effect of plant additions and retirements during the test year.

Some costs that may be included in revenue requirements are incurred at intervals less frequently than annually, provide benefits extending beyond a single year, or reoccur in significantly different amounts each year. As a result, the amount recorded in the test year may not be viewed as "normal." Normalization adjustments are made when a test year level of revenues or expenses is not representative of what would be expected on an on-going basis. Examples include rate case expenses, bad debts expense, and the overtime percentage used in computing pro forma payroll expenses.

Q. Please describe Schedule C-2.

A. Schedule C-2 consists of 19 income statement adjustments. The first two pages, (labeled "Page 1 of 2" and "Page 2 of 2") summarize the pro forma adjustments appearing on Schedule C-1, column 5. The remaining pages show the detail of each pro forma adjustment that is reflected on the first two pages of Schedule C-2. Each of those pages is identified by the adjustment letter that corresponds to the letter shown below the column numbers on Schedule C-2, pages 1 and 2.

REVENUE ADJUSTMENTS

Q. What is the purpose of Adjustment A of Schedule C-2?

A. Adjustment A consists of eleven items that increase or decrease recorded test year revenues. The adjustments are a combination of Commission-mandated filing requirements, as well as the normal adjustments made to recorded test year operating revenue. It should be noted that the revenues in column 1 of Schedule C-1 (to which the Schedule C-2 revenue adjustments are made) already reflect the removal of the Griffith revenues (shown on Schedule E-6B).

Q. Please describe the process used to determine if adjustments were required.

A. First, we reviewed the recorded revenues for the NAGD and the SCGD to determine the amounts of revenue from monthly customer billings as reflected on the Monthly Revenue Analysis ("MRA") and the amounts derived from other journal entries. Next, we developed a Bill Frequency Analysis ("BFA") for each property, and compared those analyses with the monthly customer billing amounts. Finally, Mr. Harrison, the Company's rate design witness, adjusted recorded revenues, where necessary, to reflect a normal test year for ratemaking in its presentation.

Q. Please describe the first revenue adjustment contained on Adjustment A of Schedule C-2.

A. The reclassification of revenues for the SCGD, shown on Line 2, reflects the identification of customers to be included in the Public Authority and Industrial classifications. SCGD personnel identified these customers, originally included in the Commercial class, to fit the criteria of the Public Authority and Industrial classes, which are new to the SCGD, and to conform to those at the NAGD. Because both properties will have the same tariffs, it was necessary to reclassify the revenue and associated billing determinants for these customers. This reclassification does not change the total revenue amounts.

Q. Please describe Adjustment A-1.

A. Adjustment A-1 on Line 3 removes all gas costs from the revenues of the AGD. The detail of this adjustment is shown on Page 2. The AGD revenue requirement is determined on a Gross Margin basis, because gas costs are primarily recovered through operation of the Purchase Gas Adjustor ("PGA") for each property.

Q. What is reflected in Adjustment A-2?

A. Adjustment A-2 on Line 4 removes the New Service Area Multiple ("NSAM") revenues from the recorded amounts. At its September 13, 2001 Open Meeting addressing the Company's PGA surcharge request, the Commission directed the NAGD to cease billing the NSAM when it concluded its Build Out Program (then expected to occur early in 2002). The NAGD notified the Commission that its Build Out Program and NSAM would terminate as of January 1, 2002. Because the NAGD is no longer collecting this charge, the associated revenues need to be eliminated from recorded amounts for the test year. Mr. Harrison's testimony supports the calculation of this amount, which is removed on Schedule C-2.

Q. Please describe Adjustment A-3.

A. Adjustment A-3 on Line 5 reflects the adjustment to gross revenues to weather normalize the recorded revenues. Related gas costs are shown on page 2 and are included in the gas costs removed in Adjustment A-1. Mr. Harrison supports both of these amounts in his direct testimony.

Q. What does Adjustment A-4 show?

A. Adjustment A-4 on Line 6 shows the gross revenue amounts necessary to reflect customer levels at the end of the test year. Related gas costs are shown on page 2 and are included in the gas costs removed in Adjustment A-1. Mr. Harrison supports both of these amounts in his direct testimony.

Q. Please describe Adjustment A-5.

A. Adjustment A-5 increases revenues for the "Tariff 32" revenues. The BFA identified a difference between the detailed billing determinants for this tariff class and the recorded amounts. After a review by the NAGD personnel, it was determined that the recorded revenues were understated and needed to be increased for the test year.

Q. What is Adjustment A-6?

A. Adjustment A-6 on line 8 increases recorded revenues by removing the amount of unbilled revenues reflected by the AGD at the end of the test year, which is December 31, 2001. This adjustment is necessary since Mr. Harrison's adjustment for weather normalization, shown as Adjustment A-3, includes an adjustment to account for unbilled revenues.

Q. Please describe Adjustments A-7, A-8, and A-9.

A. Like Adjustment A-5, these minor adjustments conform recorded revenue amounts to those recorded in the MRA for the calendar year. These adjustments represent prior period adjustments or corrections to restate the test year revenues to be consistent with the sales and costs occurring in the test period. Mr. Harrison compares these revenues with those calculated by multiplying the existing rates and billing determinants. He computes a booked-to-billed ratio for each rate class in order to develop appropriate rates. The approach replaces the reconciling percentage adjustment normally used in rate cases to conform the recorded to the calculated revenue amounts.

Q. Please describe Adjustment A-10.

A. Adjustment A-10 reflects the amount of an adjustment to NAGD revenues that NAGD personnel identified in May 2001, but that did not get recorded on that property's books. This amount represents revenues received in April 2001 that, because of a change in meter reading schedules, were not included in the initial April summary of revenues reported to Accounting for April revenues. When the adjustment for these April 2001 revenues was reported after the monthly close, it was not included in the revenues for May 2001. Accordingly, recorded revenues for the test year are understated. This adjustment increases recorded revenues for this proceeding. The amounts at issue will be recorded in 2002.

Q. What does page 2 of Schedule C-2, Adjustment A show?

A. Page 2 of Adjustment A reflects the gas costs related to each of the recorded revenues and revenue adjustments shown on Adjustment A, page 1. The Company has shown both the gross revenue (on page 1) and the gas costs (on page 2) for each adjustment to facilitate review.

OPERATING EXPENSES

Q. Please address the first operating expense item that you are sponsoring, relating to Uncollectible Expense and Interest on Deposits.

A. Adjustment C reduces recorded test year bad debts expense and includes in operating expenses the annualized interest on customers' deposits.

The uncollectible, or bad debts, portion of Adjustment C reduces the test year recorded expense amount to a level reflective of pro forma adjusted customer-annualized, weather-normalized test year revenues and of the average level of account write-offs, net of subsequent recoveries, experienced during the past three years. Since the portion of customer bills for the base cost of gas and the PGA are subject to write-off, such amounts have been added to the computational base.

The portion of Adjustment C relating to interest on customer deposits is related to the deduction of customer deposits from rate base, discussed in connection with Schedule B-9. It reflects the fact that such interest is typically recorded as a component of Other Interest Expense, which would not afford the Company the opportunity to recover such costs through the ratemaking process, absent this reclassification to operating expenses. The adjustment was computed based on the end-of-year balance of customer deposits and the prescribed rate of 6%.

Q. Please discuss Adjustment I, relating to Depreciation Expense.

A. Adjustment I in Schedule C-2 sets forth, by prime account, the AGD's adjusted depreciation expense for the test year using the adjusted plant balance as of December 31, 2001, and the depreciation rates proposed by Dr. White. These factors result in a significant decrease to the AGD's depreciation expense.

Q. Please describe the next operating expense item, relating to Lease Expense for New Office Facilities.

A. As noted above, subsequent to the test year, the AGD personnel relocated from the administrative office building located on Yale Street in Flagstaff, to a leased facility. This was a part of a cost-cutting approach adopted by AGD. Pro forma Adjustment J reflects the annual lease expense that is a known and measurable cost that the Company will incur. This adjustment is related to the adjustment removing the net Yale Street assets from rate base.

Q. Is there any gain that will be recognized from the eventual sale of the Yale Street facility?

A. The Company estimates that the Yale Street facility will be sold at a loss or, at best for an amount equal to the net book value of the assets to be sold, which will result in no gain.

Q. Please discuss Adjustment M, showing the Amortization on Gain on Sale of Property.

A. This Adjustment is the expense adjustment that corresponds to the rate base adjustment on Schedule B-12, as discussed above.

Q. What is Adjustment N, Maintenance Expense Related to Gas Supply Line?

A. As discussed above in connection with Adjustment B to Schedule B-~~5~~4A, Commission approval has been requested to transfer a gas supply pipeline from the SCED to the SCGD. The amounts shown on Adjustment N represent the Company's estimate of expenses the AGD will incur to maintain that gas supply line.

Q. What does Adjustment O, relating to Y2K, represent?

A. Adjustment O reflects the AGD's allocation of expenses that Citizens incurred in connection with becoming Y2K compliant. On December 7, 1998, on behalf of all of its Arizona properties, Citizens filed a request with the Commission seeking an accounting order permitting the deferral (for future regulatory consideration) of costs Citizens incurred for Y2K activities. On January 29, 1999, the Commission issued Decision No. 61382, approving the Citizens' request. In accordance with that Decision, the AGD has been deferring the expenses incurred in connection with Y2K in a special regulatory asset account.

Q. Please describe Adjustment O.

A. Adjustment O shows the total (allocated) costs that the AGD incurred for Y2K activities. I have removed from the total the internal AGD payroll expenses associated with Y2K, since those costs are already included in payroll expense.

Q. Over what period does the Company propose to amortize these Y2K expenses?

A. The AGD proposes to amortize the deferred Y2K expenses over five years. Therefore, the Company has included one-fifth of the total adjusted balance as pro forma test year operating expense adjustment. The unamortized balance of Y2K costs is included in rate base on Schedule B-1.

Q. Please explain the Postage Expense adjustment.

A. The United States Postal Service has increased the cost of several classes of postage, effective June 30, 2002. Of relevance to this proceeding, bulk rates have increased 2.3 cents for both mail that the Company sorts by five-digit zip code and by the first three digits of the zip code. These represent the two applicable rates for AGD bills. To derive the amount of this adjustment, I multiplied the postal rate increase by the annual number of bills (based on customer levels at the end of the test year). Adjustment P increases test year postage expense by $33,130 to reflect this known and measurable change.

Q. What is the Gross Revenue Conversion Faction shown on Schedule C-3?

A. Once the Company calculates the operating income deficiency, it is necessary to convert that deficiency to the equivalent annual increase in revenues by use of the Gross Revenue Conversion Factor. This factor is necessary to reflect the fact that the additional revenues requested in this application will generate additional bad debts expenses, Federal and State income taxes, and other revenue-driven expenses. The Company must perform this gross-up procedure to ensure that, after deducting the additional taxes and other revenue-driven expenses from the additional revenues, the resulting incremental net operating income is equal to the computed revenue deficiency.

HISTORIC FINANCIAL DATA

Q. What information is contained in Section E of this rate application?

A. Section E contains a variety of recorded historical financial and statistical data for the AGD for the test year ended December 31, 2001, and for the years ended December 31, 2000, and December 31, 1999. In addition, this section contains the notes to the financial statements and certain operating statistics.

COMPARATIVE SCHEDULES

Q. Would you please describe each of the schedules contained in Section E?

A. Schedule E-1 shows the AGD's comparative balance sheets. Schedule E-2 contains the AGD's comparative income statement and Schedule E-3 shows the AGD's comparative statements of changes in financial position. Schedule E-4 would require a statement of changes in stockholders' equity. Since the AGD is a division of Citizens, Schedule E-4 is not applicable to the AGD. Schedule E-5 shows the detail of utility plant in service at December 31, 1999, December 31, 2000, and December 31, 2001, as well as net plant additions. Schedule E-6 shows the comparative operating income statements in detail, setting forth revenues by class of service and operating revenue deductions by major categories. Schedule E-7 presents various operating statistics for the AGD. Schedule E-8 details taxes charged to the operation. The notes to the preceding financial statements are presented on Schedule E-9.

Q. Does this conclude your direct testimony at this time?

A. Yes, it does.

INTRODUCTION

Q. Please state your name and business address.

A. My name is Kevin H. Doherty. My business address is Citizens Communications Company, 3 High Ridge Park, Stamford, Connecticut 06905.

Q. By whom are you employed and in what capacity?

A. I am employed by Citizens Communications Company ("Citizens") as a Regulatory Accounting Manager.

Q. Please describe your current duties and responsibilities.

A. I am responsible for the preparation of regulatory studies for Citizens' Public Service Sector, which includes both the Northern Arizona Gas Division ("NAGD") and the Santa Cruz Gas Division ("SCGD"), collectively referred to as the Arizona Gas Division ("AGD" or "Company"). In addition, periodically I appear in regulatory proceedings on behalf of Citizens, and present testimony and exhibits supporting applications that have been filed.

Q. Please summarize your educational background.

A. I graduated from Pace University in 1987 with a Bachelor of Business Administration degree in Accounting, and I am currently enrolled in Pace University's MBA program. I have attended numerous seminars and presentations that addressed accounting, rates and other financial matters.

Q. Please describe your work experience.

A. From 1987 to 1989, I was employed by Arthur Young and Company as a Staff Auditor. I participated in audits for clients in the manufacturing, energy, and defense industries. I have been employed by Citizens since 1989. From 1989 until 1994, I held the position of Senior Capital Asset Accountant, responsible for preparation of various plant in service and depreciation reports, and I provided data for rate proceedings and certain bond indenture requirements. In 1994, I was promoted to Senior Regulatory Accountant and participated in rate proceedings in the states of Ohio and Illinois. In 1995, I was promoted to Regulatory Specialist, and testified on rate base in rate proceedings in the states of Pennsylvania and Arizona. In 1998, I joined a Citizens-wide team responsible for the implementation of an integrated accounting software system. In 1999, I accepted a position as Manager of Regulatory Accounting. In 2002, I testified in a rate proceeding in the state of Vermont.

Q. What areas will you address in this testimony?

A. I am presenting certain items included in Schedule B of Arizona's standard filing requirements relating to rate base, certain operating expense items included in Schedule C of the standard filing requirements, and all of the financial statements and statistical schedules contained in Schedule E of the standard filing requirements. These schedules were filed as part of this rate application and are found in their own bound volume. With respect to rate base, I will address the following:

- Summary of Rate Base Elements
- Gross Utility Plant in Service
    - Original Cost

- Reproduction Cost New ("RCN")
- Accumulated Depreciation
- Contributions in Aid of Construction ("CIAC")
- Amortization of CIAC
- Customer Deposits, Materials & Supplies, and Warm Spirit
- Advances in Aid of Construction ("AIAC")
- Gain on Sale of Property
- Y2K Deferred Costs

The summary of all rate base components, including those that I am supporting, is set forth in Schedule B-1, which is described below.

With respect to operating expenses, I am sponsoring Schedule C-1, which shows the recorded, adjusted, and pro forma income statement at present and proposed rates, and Schedule C-2, which summarizes the income statement pro forma adjustments made to the test year. I will also address the following specific adjustments to Schedule C-2:

- Revenue adjustments (Schedule C-2, Adjustment A),
    - Elimination of Unbilled Revenue (Adjustment A-6),
    - Adjustment to Detailed Bill Calculation (Adjustment A-7),
    - Adjustment to Detailed Public Authority Calculation (Adjustment A-8),
    - Elimination of Prior Year PGA Adjustment (Adjustment A-9),
    - Correction for April Revenue, Not Recorded (Adjustment A-10),
    - Miscellaneous Adjustments to Reconcile (Adjustment A-11),

- Uncollectible Expense and Interest on Deposits (Adjustment C),
- Depreciation Expense (Adjustment I),
- Lease Expense for New Office Facilities (Adjustment J),
- Amortization of Gain on Sale of Property (Schedule B-12, Adjustment M),
- Maintenance Expense Related to Gas Supply Line (Adjustment N),
- Y2K Expense (Adjustment O), and
- Postage Expense (Adjustment P).

I will also present Schedule C-3, which computes the Gross Revenue Conversion Factor. As discussed in the testimony of Messrs. Cohen and Smith, Citizens is seeking to consolidate its NAGD and SCGD properties for ratemaking purposes. Therefore, the rate base, revenue, and operating expense adjustments that I am sponsoring were calculated based on the separate recorded amounts for the two properties, and then were combined into the consolidated AGD amounts that are shown on the schedules in this filing.

RATE BASE

Q. Please describe Schedule B-1, containing the Summary of Rate Base Elements.

A. Schedule B-1 summarizes the components of rate base on both a net recorded original cost and a depreciated reproduction new cost basis. The supporting details and calculations of the various components of rate base are contained in subsequent schedules in Section B.

Q. Please discuss Gross Utility Plant in Service.

A. Schedule B-2 is a one-page exhibit that displays the pro forma original cost net plant in service for the test year that ended December 31, 2001. It includes the adjusted plant in service and accumulated depreciation for the AGD that are developed in Schedules B-4A and B-4B, respectively.

Q. Is the Company including any amounts for acquisition adjustments in its revenue requirement in this proceeding?

A. No, it is not.

Q. Where are the amounts associated with the acquisition adjustments reflected on the Company's accounting records?

A. The amounts are shown in Account 114, Plant Acquisition Adjustments, which are not part of the Utility Plant in Service that is included in Account 107.

Q. Did the Company make any adjustments to any rate base or expense elements included in the rate application that are related to the acquisition adjustments?

A. Yes, the Company has removed the Accumulated Deferred Income Taxes ("ADIT") associated with the acquisition adjustment from the recorded ADIT in its application. These adjustments are included on Schedule B-7 and supported by the testimony of Mr. Apuzzo.

Q. Is the Company requesting that any Common Plant be allocated to or from the AGD in this proceeding?

A. No, it is not. Citizens has administrative operations in Stamford, New Orleans and Rochester, where work is conducted for the benefit of the AGD. However, the Company has not included any utility plant in service from these administrative operations in its calculation of rate base in this proceeding, as shown on Schedule B-2, Line 2, and on Schedule B-6. In prior rate cases in Arizona, some of the items included as part of Common Plant have been contested. In addition, the plant value has been sufficiently depreciated so that the net plant amount is not significant when allocated to the AGD in this proceeding. For these reasons, the Company has elected to remove these elements from rate base for this filing. Removing these elements reduces the overall revenue requirement in this proceeding.

Q. Has the Company also excluded Common Plant allocations among its Arizona Operations, such as the gas and electric divisions?

A. Yes, it has. These amounts are small and would tend to offset each other. Again, rather than burden this proceeding with those items, the Company has decided to forego those allocations in this rate proceeding. In general this means that there is no allocation of AGD plant to Citizens' electric operations and no allocation of Citizens' electric plant to its AGD operations.

Q. Please describe Schedule B-3.

A. Schedule B-3 is a one-page exhibit showing the Trended RCN plant and accumulated depreciation for the AGD. The Arizona Constitution requires that the Arizona Corporation Commission ("Commission") set utility rates on the basis of a "fair value". Historically, this was established using a rate base that was equally weighted with net original cost and depreciated reproduction cost new ("RCN"). This schedule complies with that requirement by showing plant and accumulated depreciation calculated by trending original cost to produce a RCN. (In Mr. Mason's testimony, he explains the methodology for deriving the trended RCN plant amounts.) The RCN Plant in Service is brought forward from Schedule B-4, described below. On that schedule, I derive the ratio of depreciable RCN plant to depreciable original cost plant. Multiplying that ratio by the amount of original cost accumulated depreciation (from Schedule B-4B) produces the amount of RCN accumulated depreciation.

Q. What does Schedule B-4 show?

A. Schedule B-4 is a one-page summary exhibit identifying pro forma original cost and RCN as of December 31, 2001, by major plant account. This schedule serves two purposes. First, it shows the detail plant account data that are summarized on Schedule B-1. Second, it shows the detail of the total RCN (on Schedule B-3), consistent with the Arizona constitutional requirement to present a fair value rate base. The original cost plant amounts on Schedule B-4 are developed on Schedule B-4A. The RCN amounts on Schedule B-4 are developed on Schedule B-4C.

Q. Please describe Schedule B-4A.

A. Schedule B-4A starts with the recorded original cost plant amounts, categorized by major plant accounts, and shows the pro forma adjustments to plant in service. Finally, this schedule presents the pro forma plant balance as of the end of the test year.

Q. Please discuss the first pro forma adjustment, relating to the Griffith Transportation Agreement.

A. As Mr. Smith describes in his testimony, Griffith is an electric generating facility with which the NAGD has a contract to provide facilities and certain services for 20 years. The Commission approved the contract between NAGD and Griffith conditioned on the requirement that the NAGD remove all associated revenues, expenses, plant investments and related amounts in any subsequent regulatory proceeding. The NAGD has recorded all Griffith plant under a separate code in the plant accounts to ensure that such plant can be removed in the regulatory process. Similarly, the NAGD has maintained accumulated depreciation under a separate code to permit removal. Adjustment A, Column 3 on Schedule B-4A, reflects adjustments to plant to remove all Griffith-related plant investments. (Schedule B-4B, discussed below, reflects the associated adjustments to accumulated depreciation associated with this and other pro forma plant adjustments.)

Q. Please discuss Adjustment B, Column 4, relating to the SCGD Supply Line.

A. Citizens' Santa Cruz Electric Division ("SCED") owned a gas supply pipeline that was used to provide natural gas to fire its electric generators. SCED has recently transferred this asset to the SCGD to ensure that all gas plant assets are held by the AGD. The assets related to the supply pipeline have been identified, and are included as SCGD plant as shown in Column 4 of Schedule B-4A. The related accumulated depreciation is shown on Schedule B-4B.

Q. Please discuss Adjustment D, in Column 6, Schedule B-4A, relating to the NAGD Paulden Line.

A. NAGD constructed six miles of 8-inch pipeline for the specific purpose of supplying natural gas to NutriSource, LLC, a company that was developing the Paulden Greenhouse Facility for the production of greenhouse tomatoes. Unfortunately, the company's venture was unsuccessful, and NutriSource is no longer in business in Paulden, Arizona. While this pipeline does serve a handful of customers, the AGD has removed this pipeline from plant in service for purposes of this proceeding. Column 6 of Schedule B-4A reflects the removal of the Paulden Line from the plant accounts.

Q. Please discuss Adjustment E in Column 7, relating to Plant Retirements.

A. Following the test year, Citizens conducted a physical inventory of its Arizona General Plant accounts and also made a review of the plant accounting property records to determine if there were any assets on the AGD books that should be retired. As a result of these activities, Citizens determined that approximately 1.1% of total plant, $2.6 million, should be retired. The AGD will formally retire the assets so identified during the current fiscal year. I have reflected these retirements as a reduction to plant in service in Column 7 of Schedule B-4A (and the corresponding symmetric reduction to accumulated depreciation).

Q. Please describe Adjustment F in Column 8, relating to the Yale Street Building.

A. As discussed in Mr. Smith's testimony, as a cost-cutting measure, the AGD recently moved out of its administrative office building located on Yale Street and has moved into a leased facility. Both buildings are located in

Flagstaff, Arizona. The Yale Street building and associated assets have been identified, and I have removed those assets and the related Accumulated Depreciation from Plant in Service in Column 8 of Schedule B-4A and on Schedule B-4B respectively. In addition, Mr. Apuzzo has made an adjustment for the ADIT related to that plant and I have included the lease amount for the new facility as an expense in this proceeding.

Q. Please discuss Adjustment G in Column 9, relating to Allowance for Funds Used During Construction ("AFUDC").

A. As discussed in Mr. Mason's testimony, the Company (as well as other Citizens properties in Arizona) is required to adjust its AFUDC rate consistent with the settlement agreement that the Commission approved in Decision No. 61848, issued July 1999. To conform to the proper procedures outlined in the AFUDC Order, the AGD has revised its test year plant accounts. These revisions are shown in Column 9 of Schedule B-4A.

Q. Please describe the adjustments in Column 11 for Account Corrections.

A. These adjustments reflect the transfers of plant amounts among accounts that result in a zero balance on the total plant line, Line 39. Dr. White, the Company's depreciation expert, has recommended these adjustments as a result of his work in connection with his Depreciation Study.

Q. What is shown on Schedule B-4B?

A. Schedule B-4B starts with the recorded original cost accumulated depreciation, categorized by major plant accounts, and shows the pro forma adjustments corresponding to each of the pro forma plant adjustments contained in Schedule B-4A. Finally, this schedule presents the pro forma accumulated depreciation as of the end of the test year. The adjustment columns (Columns 3-11) mirror the columns as described in connection with Schedule B-4A, above, with the exception of Column 11 for the Account Corrections. This column also includes an adjustment that removes a minor debit balance in Account 365.10. This amount was incorrectly recorded in that account in prior years.

Q. Please describe Schedule B-4C.

A. Page 1 of Schedule B-4C shows the RCN plant amounts, by major plant account and by business area. In addition, the adjustments to plant shown on Schedule B-4A are trended and shown in Column 9. Page 2 of the schedule reflects a summary of the original cost plant in service by each business area that was used to determine the RCN amounts described earlier in my testimony. This is provided to verify that the Company has included all plant in its calculation of the RCN used to determine the Fair Value Rate Base. These amounts exclude the Griffith Plant adjustment.

Q. Please describe Schedule B-8.

A. Schedule B-8 is a one-page exhibit summarizing the rate base deduction for CIAC and related accumulated amortization. This exhibit shows the amount of CIAC, $8,467,783, and Accumulated Amortization, $1,733,000, at the end of the test year.

Q. Does the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts require that CIAC amounts be offset against plant?

A. Yes, it does.

Q. Does AGD comply with that FERC requirement?

A. Yes. The CIAC amounts are recorded as credits in the plant accounting system and are offset against the related plant amounts. This permits the Company to comply with the FERC requirement and also maintain the gross plant amounts with the related CIAC for presentation in rate applications. The CIAC amounts are shown on a gross basis for rate case presentation purposes and are amortized using the depreciation rates for the related accounts. The annual amortization amounts are offset against the depreciation expense amounts for the plant in compliance with the Commission practice in prior Citizens' rate cases.

Q. What is the CIAC accumulated amortization balance?

A. The CIAC accumulated amortization balance at the end of the test year is $1,733,000, as shown on Column 5 of Schedule B-8. The annual amortization amount is calculated using the approved depreciation rate times the account balance, resulting in $214,928 for the test year, as shown in Column 4 of the schedule.

Q. What is included in Schedule B-9?

A. Schedule B-9 summarizes the monthly balances of several rate base components during the test year. These components are customer deposits, materials and supplies, and the Warm Spirit Program (a low-income program described in Mr. Smith's testimony). Consistent with prior rate cases, the amounts are reflected in rate base using an average of the thirteen monthly balances ending December 31, 2001. A companion adjustment for the annualized interest on customer deposits is included in pro forma test year operating expenses as Adjustment C of Schedule C-2.

Q. Please describe Schedule B-10.

A. Schedule B-10 summarizes the rate base deduction for customer AIAC. AIAC represents amounts of non-investor supplied capital received by the Company and used to fund construction of utility plant.

Q. Please describe Schedule B-12.

A. Schedule B-12 contains a rate base deduction for deferred portions of gains realized from the sales of utility assets. In accordance with Commission policy, when utility assets are sold and removed from the provision of utility service, fifty percent of the after-tax gains are to be shared with ratepayers.

In late 1998, Citizens sold an office building located on San Francisco Street in Flagstaff to a non-utility purchaser. The building would no longer be useful or necessary in providing utility service. The transaction produced an after-tax gain totaling $140,650. Fifty percent of that amount was credited to a regulatory liability pending its disposition in the next rate case.

In November 2001, Citizens sold an office building in Cottonwood. That building was also removed from utility service. That sale produced an after-tax gain of $68,212. Fifty percent of that amount was credited to a regulatory liability pending disposition in the next rate case.

Q. What treatment does the Company propose for these gains on sale?

A. The AGD proposes to amortize the combined $104,431 deferred customer share of the gains from the property sales over a period of five years and reduce rate base by the unamortized amount. Accordingly, in this application, rate base is reduced by $104,431, with a corresponding negative amortization of $20,886 reflected in operating expense as Adjustment M on Schedule C-2.

Q. Please discuss the adjustment for Y2K costs.

A. This adjustment relates to the Company's allocated portion of Citizens' expenses incurred with becoming Y2K compliant. It is the corresponding rate base amount associated with the amortization described as Adjustment O to Schedule C-2, below. The Y2K costs and recovery that is being sought are discussed in more detail later in my testimony.

OPERATING INCOME

Q. What is shown on Schedule C-1?

A. Schedule C-1 contains the income statement for the test year ended December 31, 2001. Recorded amounts, pro forma adjustments for known and measurable changes, and the resulting pro forma test year amounts are shown for revenues, by class of service, and for operating revenue deductions by major function. The schedule also includes the effect of the requested revenue increase and the adjusted test year income statement at proposed rates.

Q. Please explain briefly the computation of pro forma test year revenues and expenses.

A. The ratemaking process involves the determination of a utility's revenue requirement based on a test year that reflects a level of operating revenues and expenses and net plant investment that is representative of normal conditions, free of any distortions. The rates to be derived are not necessarily intended to recover specific test year costs, but rather, similar costs expected to be incurred in the future.

Pro forma adjustments are made to address any revenues or expenses that are not representative of the levels expected to occur during the period in which the new rates will be in effect. Such adjustments may be in the form of eliminations, annualizations, or normalizations.

Q. What are elimination, annualization, and normalization adjustments?

A. Elimination adjustments are made to remove out-of-period items or items that are not costs or revenues related to the provision of utility service; thus, not includible in revenue requirements.

Annualization adjustments are made to reflect the full, twelve-month revenue or expense level of certain items of operating income. Examples include restating test year revenues to reflect customer levels at the end of the test year, adjusting payroll expense for the effect of salary adjustments or changes in employee levels since the beginning of the test year, and adjusting recorded depreciation expense to reflect the full effect of plant additions and retirements during the test year.

Some costs that may be included in revenue requirements are incurred at intervals less frequently than annually, provide benefits extending beyond a single year, or reoccur in significantly different amounts each year. As a result, the amount recorded in the test year may not be viewed as "normal." Normalization adjustments are made when a test year level of revenues or expenses is not representative of what would be expected on an on-going basis. Examples include rate case expenses, bad debts expense, and the overtime percentage used in computing pro forma payroll expenses.

Q. Please describe Schedule C-2.

A. Schedule C-2 consists of 19 income statement adjustments. The first two pages, (labeled "Page 1 of 2" and "Page 2 of 2") summarize the pro forma adjustments appearing on Schedule C-1, column 5. The remaining pages show the detail of each pro forma adjustment that is reflected on the first two pages of Schedule C-2. Each of those pages is identified by the adjustment letter that corresponds to the letter shown below the column numbers on Schedule C-2, pages 1 and 2.

<u>REVENUE ADJUSTMENTS</u>

Q. What is the purpose of Adjustment A of Schedule C-2?

A. Adjustment A consists of eleven items that increase or decrease recorded test year revenues. The adjustments are a combination of Commission-mandated filing requirements, as well as the normal adjustments made to recorded test year operating revenue. It should be noted that the revenues in column 1 of Schedule C-1 (to which the Schedule C-2 revenue adjustments are made) already reflect the removal of the Griffith revenues (shown on Schedule E-6B).

Q. Please describe the process used to determine if adjustments were required.

A. First, we reviewed the recorded revenues for the NAGD and the SCGD to determine the amounts of revenue from monthly customer billings as reflected on the Monthly Revenue Analysis ("MRA") and the amounts derived from other journal entries. Next, we developed a Bill Frequency Analysis ("BFA") for each property, and compared those analyses with the monthly customer billing amounts. Finally, Mr. Harrison, the Company's rate design witness, adjusted recorded revenues, where necessary, to reflect a normal test year for ratemaking in its presentation.

Q. Please describe the first revenue adjustment contained on Adjustment A of Schedule C-2.

A. The reclassification of revenues for the SCGD, shown on Line 2, reflects the identification of customers to be included in the Public Authority and Industrial classifications. SCGD personnel identified these customers, originally included in the Commercial class, to fit the criteria of the Public Authority and Industrial classes, which are new to the SCGD, and to conform to those at the NAGD. Because both properties will have the same tariffs, it was necessary to reclassify the revenue and associated billing determinants for these customers. This reclassification does not change the total revenue amounts.

Q. Please describe Adjustment A-1.

A. Adjustment A-1 on Line 3 removes all gas costs from the revenues of the AGD. The detail of this adjustment is shown on Page 2. The AGD revenue requirement is determined on a Gross Margin basis, because gas costs are primarily recovered through operation of the Purchase Gas Adjustor ("PGA") for each property.

Q. What is reflected in Adjustment A-2?

A. Adjustment A-2 on Line 4 removes the New Service Area Multiple ("NSAM") revenues from the recorded amounts. At its September 13, 2001 Open Meeting addressing the Company's PGA surcharge request, the Commission directed the NAGD to cease billing the NSAM when it concluded its Build Out Program (then expected to occur early in 2002). The NAGD notified the Commission that its Build Out Program and NSAM would terminate as of January 1, 2002. Because the NAGD is no longer collecting this charge, the associated revenues need to be eliminated from recorded amounts for the test year. Mr. Harrison's testimony supports the calculation of this amount, which is removed on Schedule C-2.

Q. Please describe Adjustment A-3.

A. Adjustment A-3 on Line 5 reflects the adjustment to gross revenues to weather normalize the recorded revenues. Related gas costs are shown on page 2 and are included in the gas costs removed in Adjustment A-1. Mr. Harrison supports both of these amounts in his direct testimony.

Q. What does Adjustment A-4 show?

A. Adjustment A-4 on Line 6 shows the gross revenue amounts necessary to reflect customer levels at the end of the test year. Related gas costs are shown on page 2 and are included in the gas costs removed in Adjustment A-1. Mr. Harrison supports both of these amounts in his direct testimony.

Q. Please describe Adjustment A-5.

A. Adjustment A-5 increases revenues for the "Tariff 32" revenues. The BFA identified a difference between the detailed billing determinants for this tariff class and the recorded amounts. After a review by the NAGD personnel, it was determined that the recorded revenues were understated and needed to be increased for the test year.

Q. What is Adjustment A-6?

A. Adjustment A-6 on line 8 increases recorded revenues by removing the amount of unbilled revenues reflected by the AGD at the end of the test year, which is December 31, 2001. This adjustment is necessary since Mr. Harrison's adjustment for weather normalization, shown as Adjustment A-3, includes an adjustment to account for unbilled revenues.

Q. Please describe Adjustments A-7, A-8, and A-9.

A. Like Adjustment A-5, these minor adjustments conform recorded revenue amounts to those recorded in the MRA for the calendar year. These adjustments represent prior period adjustments or corrections to restate the test year revenues to be consistent with the sales and costs occurring in the test period. Mr. Harrison compares these revenues with those calculated by multiplying the existing rates and billing determinants. He computes a booked-to-billed ratio for each rate class in order to develop appropriate rates. The approach replaces the reconciling percentage adjustment normally used in rate cases to conform the recorded to the calculated revenue amounts.

Q. Please describe Adjustment A-10.

A. Adjustment A-10 reflects the amount of an adjustment to NAGD revenues that NAGD personnel identified in May 2001, but that did not get recorded on that property's books. This amount represents revenues received in April 2001 that, because of a change in meter reading schedules, were not included in the initial April summary of revenues reported to Accounting for April revenues. When the adjustment for these April 2001 revenues was reported after the monthly close, it was not included in the revenues for May 2001. Accordingly, recorded revenues for the test year are understated. This adjustment increases recorded revenues for this proceeding. The amounts at issue will be recorded in 2002.

Q. What does page 2 of Schedule C-2, Adjustment A show?

A. Page 2 of Adjustment A reflects the gas costs related to each of the recorded revenues and revenue adjustments shown on Adjustment A, page 1. The Company has shown both the gross revenue (on page 1) and the gas costs (on page 2) for each adjustment to facilitate review.

OPERATING EXPENSES

Q. Please address the first operating expense item that you are sponsoring, relating to Uncollectible Expense and Interest on Deposits.

A. Adjustment C reduces recorded test year bad debts expense and includes in operating expenses the annualized interest on customers' deposits.

The uncollectible, or bad debts, portion of Adjustment C reduces the test year recorded expense amount to a level reflective of pro forma adjusted customer-annualized, weather-normalized test year revenues and of the average level of account write-offs, net of subsequent recoveries, experienced during the past three years. Since the portion of customer bills for the base cost of gas and the PGA are subject to write-off, such amounts have been added to the computational base.

The portion of Adjustment C relating to interest on customer deposits is related to the deduction of customer deposits from rate base, discussed in connection with Schedule B-9. It reflects the fact that such interest is typically recorded as a component of Other Interest Expense, which would not afford the Company the opportunity to recover such costs through the ratemaking process, absent this reclassification to operating expenses. The adjustment was computed based on the end-of-year balance of customer deposits and the prescribed rate of 6%.

Q. Please discuss Adjustment I, relating to Depreciation Expense.

A. Adjustment I in Schedule C-2 sets forth, by prime account, the AGD's adjusted depreciation expense for the test year using the adjusted plant balance as of December 31, 2001, and the depreciation rates proposed by Dr. White. These factors result in a significant decrease to the AGD's depreciation expense.

Q. Please describe the next operating expense item, relating to Lease Expense for New Office Facilities.

A. As noted above, subsequent to the test year, the AGD personnel relocated from the administrative office building located on Yale Street in Flagstaff, to a leased facility. This was a part of a cost-cutting approach adopted by AGD. Pro forma Adjustment J reflects the annual lease expense that is a known and measurable cost that the Company will incur. This adjustment is related to the adjustment removing the net Yale Street assets from rate base.

Q. Is there any gain that will be recognized from the eventual sale of the Yale Street facility?

A. The Company estimates that the Yale Street facility will be sold at a loss or, at best for an amount equal to the net book value of the assets to be sold, which will result in no gain.

Q. Please discuss Adjustment M, showing the Amortization on Gain on Sale of Property.

A. This Adjustment is the expense adjustment that corresponds to the rate base adjustment on Schedule B-12, as discussed above.

Q. What is Adjustment N, Maintenance Expense Related to Gas Supply Line?

A. As discussed above in connection with Adjustment B to Schedule B-4A, Commission approval has been requested to transfer a gas supply pipeline from the SCED to the SCGD. The amounts shown on Adjustment N represent the Company's estimate of expenses the AGD will incur to maintain that gas supply line.

Q. What does Adjustment O, relating to Y2K, represent?

A. Adjustment O reflects the AGD's allocation of expenses that Citizens incurred in connection with becoming Y2K compliant. On December 7, 1998, on behalf of all of its Arizona properties, Citizens filed a request with the Commission seeking an accounting order permitting the deferral (for future regulatory consideration) of costs Citizens incurred for Y2K activities. On January 29, 1999, the Commission issued Decision No. 61382, approving the Citizens' request. In accordance with that Decision, the AGD has been deferring the expenses incurred in connection with Y2K in a special regulatory asset account.

Q. Please describe Adjustment O.

A. Adjustment O shows the total (allocated) costs that the AGD incurred for Y2K activities. I have removed from the total the internal AGD payroll expenses associated with Y2K, since those costs are already included in payroll expense.

Q. Over what period does the Company propose to amortize these Y2K expenses?

A. The AGD proposes to amortize the deferred Y2K expenses over five years. Therefore, the Company has included one-fifth of the total adjusted balance as pro forma test year operating expense adjustment. The unamortized balance of Y2K costs is included in rate base on Schedule B-1.

Q. Please explain the Postage Expense adjustment.

A. The United States Postal Service has increased the cost of several classes of postage, effective June 30, 2002. Of relevance to this proceeding, bulk rates have increased 2.3 cents for both mail that the Company sorts by five-digit zip code and by the first three digits of the zip code. These represent the two applicable rates for AGD bills. To derive the amount of this adjustment, I multiplied the postal rate increase by the annual number of bills (based on customer levels at the end of the test year). Adjustment P increases test year postage expense by $33,130 to reflect this known and measurable change.

Q. What is the Gross Revenue Conversion Faction shown on Schedule C-3?

A. Once the Company calculates the operating income deficiency, it is necessary to convert that deficiency to the equivalent annual increase in revenues by use of the Gross Revenue Conversion Factor. This factor is necessary to reflect the fact that the additional revenues requested in this application will generate additional bad debts expenses, Federal and State income taxes, and other revenue-driven expenses. The Company must perform this gross-up procedure to ensure that, after deducting the additional taxes and other revenue-driven expenses from the additional revenues, the resulting incremental net operating income is equal to the computed revenue deficiency.

HISTORIC FINANCIAL DATA

Q. What information is contained in Section E of this rate application?

A. Section E contains a variety of recorded historical financial and statistical data for the AGD for the test year ended December 31, 2001, and for the years ended December 31, 2000, and December 31, 1999. In addition, this section contains the notes to the financial statements and certain operating statistics.

COMPARATIVE SCHEDULES

Q. Would you please describe each of the schedules contained in Section E?

A. Schedule E-1 shows the AGD's comparative balance sheets. Schedule E-2 contains the AGD's comparative income statement and Schedule E-3 shows the AGD's comparative statements of changes in financial position. Schedule E-4 would require a statement of changes in stockholders' equity. Since the AGD is a division of Citizens, Schedule E-4 is not applicable to the AGD. Schedule E-5 shows the detail of utility plant in service at December 31, 1999, December 31, 2000, and December 31, 2001, as well as net plant additions. Schedule E-6 shows the comparative operating income statements in detail, setting forth revenues by class of service and operating revenue deductions by major categories. Schedule E-7 presents various operating statistics for the AGD. Schedule E-8 details taxes charged to the operation. The notes to the preceding financial statements are presented on Schedule E-9.

Q. Does this conclude your direct testimony at this time?

A. Yes, it does.